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TAGS: FFIN ECON RS

SUBJECT: OUTLOOK FOR RUSSIA'S NEW FINANCIAL MARKETS CHIEF

Classified By: ECON M/C Pam Quanrud, Reasons 1.4 (b/d).

Summary

¶1. (SBU) On May 9, Prime Minister Mikhail Fradkov appointed one of his economic advisors, Vladimir Milovidov, as the new Director of the Federal Service for Financial Markets (FSFM). Milovidov's appointment came in the immediate aftermath of outgoing FSFM chief Oleg Vyugin's announcement that he was stepping down to return to the private sector. Analysts widely credit Vyugin with setting Russia's financial market regulation on the right path, a critical change from the tenure of his predecessor, Igor Kostikov. Milovidov, who worked for the FSFM's predecessor agency from 2000-2003 and was Kostikov's deputy, is expected to carry on the work Vyugin initiated to: attract more financial market issuances to Russia; improve efficiency in financial market activities; expand the cadre of economically savvy regulators; and strengthen cooperation with law enforcement in the area of financial crimes. While Milovidov will likely press Vyugin's unfinished goals of establishing a central depository and passing an insider trading law, any efforts toward turning the FSFM into a "megaregulator" will likely be delayed. End Comment.

Vyugin Leaves Financial Markets Service

¶2. (C) On May 8, Director of the Federal Service for Financial Markets (FSFM) Oleg Vyugin announced his intention to step down and return to a career in the private sector. In 2004, Vyugin left his post as a Deputy Chairman of the Central Bank to become the first chief of the FSFM, which had been created as part of a package of administrative reforms in 2004. The new agency was given greater regulatory authority than its predecessor, the Federal Securities Commission, had enjoyed. According to Sergey Drobyshevsky, Director of Macroeconomic Studies at the Institute for the Economy in Transition (Gaidar Institute), Vyugin assumed leadership of the new agency at a time when financial managers and market analysts had been sharply critical of his predecessor, Federal Securities Commission Chairman Igor Kostikov. High transaction costs, lack of market infrastructure investments, and slow developments in ownership registration had combined to push securities placements to more attractive locales such as the London Stock Exchange. The GOR tacitly recognized this state of affairs and reorganized the Federal Securities Commission to address these issues.

¶3. (C) Fradkov viewed the new FSFM as a megaregulator-in-waiting, calling the agency "a second Central Bank." Vyugin, however, focused on improvements in Russia's capital markets, not on the establishment of a unified financial markets regulator. His chief aim was to prevent Russian capital from further "escaping abroad," according to Rory Macfaquhar, Chief Economist at Goldman Sachs Moscow office. Vyugin made significant strides in reducing the costs of issuing securities in Russia and thereby increased liquidity in the national market. In June 2006, the FSFM began requiring Russia's publicly traded companies to issue 30 percent of new securities in Russia, which helped significantly increase daily trading volumes domestically. Vyugin also spearheaded amendments in the Law on Mortgage-Backed Securities to make the instruments more accessible to large investors. This change allowed the Deposit Insurance Agency to announce in November 2006 that it would invest its premiums in mortgage-backed securities.

Picking Up Where Vyugin Left Off

¶4. (C) The consensus among financial analysts is that Vladimir Milovidov's tenure at the helm of the FSFM will probably be too short (because of the presidential election in March 2008) to make a substantial impact. Renaissance Capital's Director of Research Roland Nash noted that Vyugin had brought an excellent reputation with him, which instilled confidence among market participants that the changes he sought were practical. Deutsche Bank Chief Economist Yaroslav Lissovlik speculated that Milovidov's close relationship with Fradkov will translate into a slightly higher priority for the legislative goals that seemed to elude Vyugin: an insider trading law and creation of a central depository. Lissovlik said the relationship would not, however, guarantee the approval of draft legislation.

Prospects for a "Megaregulator"

¶5. (C) Discussions on the formation of a financial markets megaregulator will probably persist as the Russian economy continues to absorb greater streams of net capital inflows, according to analysts. However, Drobyshevky suggested that the megaregulator bill Vyugin had been developing prior to his departure would probably wither and not be presented to the Cabinet. Moreover, he said that the money laundering concerns that sparked this debate will need to be rectified before the GOR establishes a megaregulator. (Note: Current legislation prohibits banks from refusing to open accounts or complete transactions even if the bank's risk assessments determine a prospective client or transaction is suspicious. End Note.) Lissovlik predicted the GOR's regulatory efforts would be directed toward strengthening the banking sector and carrying on Vyugin's work to promote greater corporate transparency. Lissovlik said the FSFM would also encourage further development of the derivatives markets.

Comment

¶6. (C) Oleg Vyugin left office with a series of critical accomplishments to his name, and he leaves on a high note. He helped restore investor confidence, increase liquidity, and reduce transaction costs. Vyugin is also widely held to be one of the few truly "uncorrupt" in positions of power in Russia--in stark contrast to his predecessor, Kostikov. Insiders say Vyugin's move to MDM Bank (and not a foreign bank, although Goldman Sachs was a strong rumor) was taken now to put him in a better position to come back into the government after the 2008 election.

¶7. (C) Perhaps Vyugin's departure was borne of frustration with not being able to develop a consensus around his vision for a central depository and an insider trading law. Both issues featured prominently in his early public statements on

the new FSFM's priorities. Taking up the charge now falls to Vyugin's successor, Vladimir Milovidov. Market participants credit Milovidov with mitigating Kostikov's "excesses" during his three years as Kostikov's deputy. Milovidov's return to the market regulator seat has been uniformly welcomed by our contacts. End Comment.

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